

Memorandum of Understanding between the Financial Reporting Council and the Department for Levelling Up, Housing and Communities

2 March 2023

Introduction

A strong, well-functioning local audit system is essential to maintain public confidence in transparent and accountable local democracy. Local authorities must be able to plan, manage their services and base their decision-making on accurate and reliable financial information. As Accounting Officer for local government, the Department for Levelling Up, Housing and Communities (DLUHC) is responsible for ensuring that local audit operates effectively. Local audit is vital to the proper exercise of DLUHC's stewardship role in respect of local government and forms an integral part of the core local government accountability framework; through the audit and timely completion of the Whole of Government Accounts, it is also instrumental to assuring the public sector more broadly.

The Government's priorities for the local audit system are for high quality, relevant audits to be completed on time by a properly resourced audit sector operating within a sustainable market, underpinned by transparency and strong governance. The current local audit system faces a range of challenges, some immediate, others structural and longer term. Sir Tony Redmond's [Independent Review of Local Authority Audit and Financial Reporting](#) (the 'Redmond Review') was commissioned as an opportunity for the Government to consider the effectiveness of the local authority financial reporting and audit regime created through the Local Audit and Accountability Act 2014¹. The Redmond Review identified the dispersal of oversight across the local audit system as a key problem. To address this, Sir Tony recommended the establishment of a system leader to consolidate functions and drive a coherent, whole system response to challenges arising.

The Department's 2021 Spring Update on the Redmond Review proposed that the Audit, Reporting and Governance Authority (ARGA), which the Government intends will replace the Financial Reporting Council (FRC), should act as system leader for local audit. Further detail on these proposals were published in [Local Audit framework: technical consultation](#). The Government intends to formally establish ARGA through primary legislation, in advance of which shadow system leader arrangements will start at the FRC. Since July 2021, DLUHC has acted as interim system leader by establishing and chairing the local audit Liaison Committee² of senior stakeholders and by leading work to agree a system wide package of measures to reduce local audit delays (further detail below).

¹ The Redmond Review formed the post-implementation review of local audit aspects of the 2014 Local Audit and Accountability Act. Terms of Reference can be viewed [here](#).

² <https://www.gov.uk/government/groups/local-audit-liaison-committee>

Purpose

This Memorandum of Understanding (MoU) sets out what has been agreed between DLUHC and the FRC on the roles and responsibilities the FRC will take on as system leader during the shadow period, which will precede the intended establishment of ARGA through legislation, when full system leadership is intended to commence.

The process of local audit is complex and the arena in which it is conducted is dynamic. To respond to challenges and opportunities, the local audit system needs a leading voice and a coordinating hand.

To fulfil this role the FRC will have five areas of responsibility as system leader:

1. Lead a coherent and coordinated response to challenges arising across the system.
2. Facilitate stronger governance across the local audit framework.
3. Lead work to improve competition, bolster capability and market supply.
4. Oversee the entire quality framework for local audit.
5. Report on the local audit system.

This MoU does not alter or enhance the existing statutory duties of either party. DLUHC will remain responsible for local government reporting requirements, the local government accountability framework, adherence to the Best Value duty, stewardship and policy decisions. The FRC will have no additional statutory powers or decision-making authority. The shadow period will enable an assessment of how system leader arrangements work in practice, therefore we will plan to review the MoU after one year of shadow arrangements.

This document sets out the over-arching responsibilities of the shadow system leadership role for local bodies in England and the nature of the relationship between DLUHC and the FRC; with DLUHC being the counterparty to this MoU with the FRC. DLUHC also liaises with the Department of Health and Social Care (DHSC) and National Health Service (NHS) England, the Department for Environment, Food and Rural Affairs (DEFRA), the Home Office (HO) and His Majesty's Treasury (HMT).³

While this document is not a legal or binding agreement, both DLUHC and the FRC are committed to working to it.

The FRC's responsibilities as system leader during the shadow period

As set out above, the Government's priority for an effective local audit system across all local bodies is for high quality and useful audits to be completed on time by a properly resourced audit sector operating within a sustainable market, underpinned by transparency and strong governance. Delivery of this will depend on addressing both immediate challenges and structural issues, which will require longer term work.

The local audit system leader will have five areas of responsibility in support of the Government's priorities during the shadow period. Shadow local audit system leader work will be led by the Director of Local Audit who will lead a dedicated local audit department within the FRC. The Director and the department they lead will have sight of all local audit-related work at the FRC and

³ This reflects that audited bodies (and related local audit processes) covered by the 2014 Local Audit and Accountability Act include NHS bodies and a broad range of local authorities such as Fire and Rescue Authorities, Police and Crime Commissioners, National Parks authorities and drainage boards.

lead or be consulted on decisions overlapping with local audit, including where dispersed across other functions within the organisation. The Executive Director of Supervision will report on local audit to the FRC board, to which (subject to the established process for appointments to the FRC board) a member with responsibility for local audit and commensurate experience will be appointed.

1. Lead a coherent and coordinated response to challenges arising across the local audit system, working across and between organisations as required

DLUHC remains committed to delivering on the Redmond Review, which identified the need for a system leader to enable a coherent and consistent response to challenges across the system. The work which DLUHC has led as interim system leader to develop a system wide approach to delays in local audit completion is an active example of a system leader response to a challenge arising across the local audit system. The Department also recognises that the many elements of the local audit process (including local authority financial reporting and associated governance) and the dynamic arena in which local audit is conducted means that challenges and opportunities – and the associated response to those – will change.

To determine its policy priorities, the FRC as system leader will need to identify both short term and long term systemic challenges, triage those flagged through the system and advise DLUHC of its policy priorities. As Accounting Officer for local audit, DLUHC will send the system leader an annual Remit Letter setting out the priorities which the Department judges should inform the system leader's policy development for the period, in line with the roles and responsibilities set out in this document. The system leader will be required to publish a reply to the Remit Letter within a specified timeframe in which it will set out its response and the actions it plans to take. A Remit Letter may also be sent by exception, for example where unexpected circumstances or challenges impact the local audit system.

To lead a coordinated policy response, the FRC will need to:

- a. Act as a visible leader, articulating clear priorities and recommendations. Be responsible for generating, driving and overseeing an integrated response to challenges which arise across the system or improvements which could be made. To deliver this, the FRC will actively lead discussions and commission work across a wide range of stakeholders as required; the system leader will monitor progress on the delivery of measures agreed, but these will remain the responsibility of individual organisations. The work DLUHC led to produce the December 2021 package of [Measures to improve local audit delays](#) is an example of driving such a systemic approach, with a range of measures agreed to be delivered by individual organisations.
- b. Support broader and relevant work led by any member of the Liaison Committee. The system leader will be working with the four other bodies which make up the local audit system: the Chartered Institute of Public Finance and Accountancy (CIPFA), the Comptroller & Auditor General and the National Audit Office (NAO), the Institute of Chartered Accountants of England and Wales (ICAEW) and the Public Sector Audit Appointments Ltd (PSAA). The system leader will not lead or commission all work across the local audit system, but in order to drive forward whole system reform it needs to be abreast of and support or feed into work underway by members of the Liaison Committee.

- c. Support broader and relevant work led by Government, and where required, engage with or make recommendations to DLUHC to contribute to policy development. In cases where an organisation within the system cannot take the action which the FRC concludes is required, Government may need to act. The FRC as shadow system leader will be required to advise DLUHC of such instances, setting out the rationale for any proposed action, which DLUHC will consider.
- d. Establish and maintain a clear distinction between the exercise of its existing regulator role within the system and its role as overarching system leader for local audit. Stakeholders need to be clear 'which FRC' they are engaging with on issues which may overlap with regulatory functions where ethical walls may be required. Equally, to assure a holistic integrated approach which recognises the overlapping imperatives across the system, as system leader the FRC will also need to make and harness connections with those separate functions within its own organisation.
- e. Build strong relationships with stakeholders across the local audit process including sector bodies, establishing networks, reference groups or working groups as required. For example, as interim system leader DLUHC convened a timeliness working group to examine current challenges including concerns raised by auditors over the reliability of local authorities' valuation of infrastructure assets.
- f. Work to establish requisite agreements and gateways between itself and organisations across the system for the timely sharing of high quality information, intelligence and data needed to investigate the root causes of challenges across local audit and to produce targeted and meaningful reports on local audit.
- g. At a suitable juncture during the shadow period, assume the chair of the Liaison Committee of senior stakeholders (currently held by DLUHC), to lead its programme and risk management. Ahead of the establishment of ARGA, and in consultation with DLUHC and Liaison Committee members, the FRC will conduct work to consider the optimal shape and make up of future Liaison Committee membership, and the committee's terms of reference. The committee will be a key conduit through which networks and stakeholders can escalate issues, agree actions and members can report on work underway across the system.
- h. Work closely with DLUHC to explore and keep under review how the entire local audit process (including financial reporting and financial management within local authorities and the NHS) can be brought into whole system work on improvements, reform and solutions to local audit.
- i. Give evidence to the Public Accounts Committee and departmental Select Committees as required on matters related to local audit.
- j. Act as an advocate and champion for local audit, within the broader statutory audit landscape (including forums) and across government as required.

2. Facilitate stronger governance across the local audit framework

Stronger governance across the new framework should include harnessing the Liaison Committee to facilitate decision making across the local audit system to affect positive change and hold stakeholders to account.

Improved coordination and collaboration should be fostered, whereby changes likely to impact the system are shared at system level in a timely manner in advance of

implementation (for example, regulatory changes or changes to the fines regime likely to impact the market).

- a. DLUHC will remain responsible for the procurement arrangements for local audit. This includes overseeing the Appointing Person (currently PSAA), which has been granted authority by the Secretary of State to appoint auditors to local government bodies that wish to opt into its scheme.
- b. The FRC will need to work with DLUHC and the Appointing Person to ensure that objectives for local audit procurement⁴ are aligned with the objectives of the wider system, which also includes a range of local and health bodies who appoint their own auditors.
- c. Following the awarding of contracts for 2023/24-27/28, PSAA will continue to support the system through managing contracts on behalf of c.470 local authorities and we expect the system leader to take an active interest in these areas.
- d. In the longer term, as we approach the next appointing period (i.e. from 2028/29 onwards), we expect the system leader to facilitate input from the Liaison Committee into any procurement strategy being developed in this period.

The Department has committed to keep the procurement arrangements for local government audit under review, so this system leader responsibility may change accordingly.

3. Lead work to improve competition, bolster capability and market supply

As set out in DLUHC's December 2021 package, market sustainability is a long term, complex challenge. Leading a holistic, system wide approach to this will require the system leader to work with stakeholders across the system and beyond to develop a clear view of the component and overlapping elements of this issue across all local bodies and develop a programme to address these.

The system leader will lead work to address competition and capacity in the market. This will encompass a spectrum of activities, including:

- a. Building on the immediate capacity and capability work which has been led up to now by a working group of the Local Audit Monitoring Board (LAMB) and through the broader suite of actions proposed in the December 2021 package of *Measures to improve local audit delays*;
- b. Starting immediate work with DLUHC and audit firms on a workforce strategy committed to in *Measures to improve local audit delays* published in December 2021.

Feeding into or leading elements of the wider policy work which it is intended that once established ARGAs will conduct on the statutory audit market in support of its overarching statutory competition objective.

⁴ The objectives of the procurement strategy for the second appointing period can be accessed [here](#).

4. Oversee the entire quality framework for local audit

In the current local audit system the quality framework is dispersed across the Comptroller and Auditor General (who sets the Code of Audit Practice, assisted by a dedicated team at the NAO) and the FRC, which is responsible for the Audit Quality Review framework and professional oversight.

These responsibilities will continue during the shadow period, but when ARGA is created through intended primary legislation, it is the Government's intention that the Code of Audit Practice will be transferred from NAO to ARGA, which will then oversee the entire quality framework as system leader.

- a. During the shadow period the FRC will need to prepare for the intended transfer of the Code of Audit Practice and make arrangements for maintaining the associated activities conducted in support of the Code which the Government has committed to continue.

The Government has committed to conduct a post-implementation review of changes to the Value for Money judgement arrangements introduced in the 2020 update of the Code of Audit Practice, to assess whether these have led to more effective external audit consideration of financial resilience and value for money matters.

The Value for Money judgement component of the Code of Audit Practice is a distinctive element of local government audit and integral to DLUHC's assessment of risk to inform its Accounting Officer and stewardship functions.

- b. During the shadow period the FRC will work with the NAO to develop a post implementation review, which the Government has provisionally agreed should take place within three years of the updated Code change, or as soon after as feasibly possible.

5. Report on the local audit system

There is currently no requirement for annual reporting on the functioning of the local audit system and what broad trends or issues local audits may be surfacing in a single year. The Redmond Review recommended that reporting on local audit should be a responsibility of the system leadership and responses to the Local Audit Framework: technical consultation strongly supported the proposal that there should be annual reporting on the local audit system.

To report on the local audit system the FRC will need to:

- a. Lead work to report annually, in the public sphere, on local audit: on timeliness, on the findings of local audit, overall trends/patterns emerging from local audits and the state of the local audit market.
- b. The system leader's reporting on local audit should itself be timely, evidence-driven and should relate to the local audit cycle. The intelligence it provides on the findings of local audit should be current enough to constructively inform both the sector and

- DLUHC's stewardship and Accounting Officer functions, to which end it should liaise closely with the Office for Local Government, once established, on data sharing.
- c. The FRC will set out the scope of reporting (including for health audit and the broad range of local audit processes), how this will be conducted, commissioned and convened and what the outputs will be, determine the data local audit stakeholders will need to share to enable its planned reports and agree gateways for data to be shared on a timely responsive basis.
 - d. The FRC will continue to produce an annual report on the findings of its Audit Quality Reviews. The system leader will also work with other organisations as it considers appropriate, proposing and feeding into thematic reviews and assessments.

The Comptroller and Auditor General will continue to have a duty to produce Value for Money studies across government and local government; the Comptroller and Auditor General has also reported on the timeliness of local audit. The findings of these (and any accompanying recommendations made to DLUHC or His Majesty's Treasury) should be reflected in the system leader's reporting on the local audit system.

DLUHC responsibilities during the shadow period

As the Accounting Officer for DLUHC the Permanent Secretary is responsible for the core local government accountability framework and for maintaining the effectiveness of the local audit system framework. DLUHC will also remain responsible for adherence to the Best Value duty, stewardship, local government financial reporting requirements and policy decisions.

DLUHC is committed to supporting the FRC throughout the shadow transition period during which it will fulfil the following responsibilities; both parties have agreed to governance and assurance standards.

- a. DLUHC will commission work as required (directly and through the Remit Letter) and work with the system leader to review progress on its responsibilities and activities.
- b. The FRC's role as shadow system leader for local audit will be funded directly by Government under a process to be agreed by both parties (and without which funding the FRC will not be able to carry out the role).
- c. DLUHC will continue to develop policy on local audit and accountability to support the Department's Accounting Officer function and stewardship work.
- d. Subject to ministerial clearance, DLUHC will also undertake policy work as commissioned by the FRC where there is a need for ministerial decisions or statutory action in the sector.
- e. DLUHC will consult the system leader on any proposed changes to the local audit system.
- f. DLUHC will engage in consultations conducted by the system leader on future policy/aspects of the system leader role or wider issues of local authority financial reporting and audit.
- g. DLUHC and the FRC will work together to agree public-facing comms where required on systemic issues. This will not cover the communications the FRC conducts in its regulatory, supervision and enforcement capacity.
- h. DLUHC will respond in a timely fashion to commissions/requests from the system leader.
- i. DLUHC will lead on engagement and attendance at Public Accounts Committee hearings, supported by the FRC.
- j. DLUHC will continue to oversee the Appointing Person for local audit, as specified by the Secretary of State.

- k. DLUHC will continue to lead on the procurement and establishment of the Technical Advisory Service and Local Audit Qualification in alignment with the capability, capacity and workforce strategy work led by the system leader.
- l. DLUHC will continue to chair the Liaison Committee in the early shadow period, ahead of passing the chair to the FRC at a suitable juncture to be agreed.
- m. DLUHC will continue to liaise with DHSC and NHS England to develop and implement policy for local audit.
- n. During the shadow period, DLUHC will continue to convene the Local Audit Monitoring Board (LAMB).

Governance and assurance

The governance mechanisms DLUHC and the FRC have committed to for local audit system risk and for system leadership programme delivery are attached in summary diagrams at Annexes A and B.

DLUHC and the FRC are committed to the following governance and risk management arrangements to support their respective roles during the shadow period:

- a. In addition to the activities set out in the MoU, DLUHC will set out policy priorities in a Remit Letter to be sent annually and by exception where circumstances require.
- b. The FRC's Annual Report will include a discrete section on local audit system leadership.
- c. DLUHC's reliance on the FRC to lead the local audit system during the shadow period will be set out and published in the DLUHC's Annual Report and Accounts; and the Accounting Officer System Statement (specifically the annex on Local Government).
- d. The FRC will respond to any information commissions from the DLUHC within 10 working days.
- e. The FRC will engage constructively to meet any *ad hoc* monitoring requests from DLUHC.
- f. The FRC will inform DLUHC of any significant delivery concerns or financial risks as they arise.
- g. Accounting Officer and CEO meetings will be held every 6 months.
- h. Senior official meetings will be held every quarter between DLUHC's Director General for Local Government, Resilience and Communities and the FRC's Executive Director of Supervision, with directors in attendance.

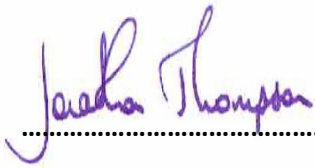
Quarterly programme oversight meetings at director level will cover but not be limited to:

- a. Financial reporting and financial forecasts of the FRC team.
- b. Business project and programme management plans – progress against delivery.
- c. Key risks including risk owner and mitigations.

Monthly meetings between the FRC Director of Local Audit and DLUHC Director of Local Government Policy on local audit system leadership will cover but not be limited to:

- a. Progress against responsibilities.
- b. Progress against Remit Letter priorities.
- c. Liaison Committee risk register management.
- d. Policy proposals.
- e. Policy proposals which need DLUHC support.
- f. System governance.
- g. Local audit completion figures. This will require the provision of high quality and timely data to the FRC by other stakeholders in the system.

Signatories



..... for the Financial Reporting Council

Name: Sir Jonathan Thompson

Description: Chief Executive Officer

Date: 28/02/2023



..... for the Department for Levelling Up, Housing and Communities

Name: Catherine Frances

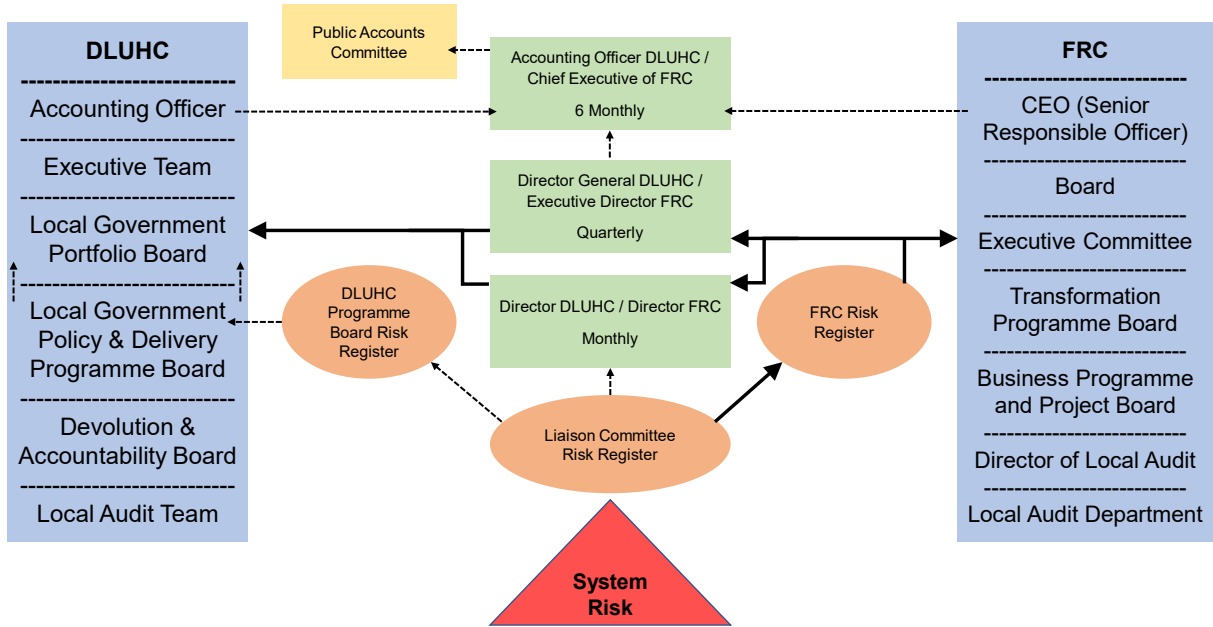
Description: Director General, Local Government, Resilience and Communities

Date: 02/03/2023

Annex A

System Risk

This diagram sets out the governance for risk management of local audit system risk:



Annex B

Programme Risk

This diagram sets out the oversight of programme risk during shadow system leadership:

